No. 91-570

IN THE

Supreme Court of the United States

October Term, 1991

PMI INDUSTRIES, INC., CONTROL SYSTEMS CORPORATION, WEDGE GROUP, INC. AND SALOMON BROTHERS INC,

Petitioners,

v.

FOLGER ADAM COMPANY,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

REPLY BRIEF FOR PETITIONERS

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Petitioners PMI Industries, Inc. ("PMI"), Control Systems Corporation ("CSC"), WEDGE Group, Inc. ("WEDGE") and Salomon Brothers Inc ("Salomon"), defendants-appellees below, respectfully submit this reply brief in further support of their petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

BACKGROUND OF THE CASE

Plaintiff Folger Adam Company's ("Folger Adam") claims arose out of its purchase from PMI of the stock of two subsidiaries, Stewart-Decatur Security Systems, Inc. ("Stewart") and The William Bayley Company ("Bayley"). Folger Adam alleged violations of Section 12(2) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C.

§ 771(2), Section 10(b) of the Securities Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), Securities and Exchange Commission Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, and the common law.

The dispositive issue presented to the jury was whether (a) certain projections furnished to Folger Adam were "materially" misleading, and (b) omitted and admittedly hastily-drawn projections by managers of Stewart and Bayley who had a history of "serv[ing] up numbers that were to easy to hit" and who were interested in purchasing the companies themselves, were "material." After hearing seven weeks of evidence concerning the nature of the projections given and omitted and the wealth of information uncovered by Folger Adam in the due diligence process, the jury found no material misrepresentation or omission, and returned a verdict for defendants. The United States District Court for the Southern District of New York (Knapp, J.) entered judgment in accordance with the verdict.

The Court of Appeals reversed the judgment on the grounds that the jury "may have" been confused in its deliberation because the District Court instructed (a) that information is "material" if it would significantly alter the "total mix" of information made available, without also explicitly stating that such information need not change the reasonable investor's decision, and (b) that "alter the 'total mix'" means "alter [one's] views as to the desirability of proceeding with the transaction."

ARGUMENT

THE COURT OF APPEALS' DECISION IS PLAINLY ERRONEOUS AND OF PROFOUND SIGNIFICANCE AND SHOULD BE SUMMARILY REVERSED

Petitioners urge the Court to, *inter alia*, summarily reverse this decision by the Court of Appeals because it is plainly erroneous and will profoundly affect the use of this Court's "alter the 'total mix'" test for determining materiality under federal securities laws. Pet. at

15-21.[1] Contrary to the Court of Appeals' decision, neither *"altering the 'total mix'"* nor *"altering views as to the desirability of proceeding* with the transaction" necessitates or even suggests a *changing of the vote to proceed*, and the reversal by the Court of Appeals of a seven-week trial that concluded with a verbatim rendition of this Court's "total mix" test—and the instruction to add to its charge a completely different formulation for materiality on remand—already has begun to eviscerate the test.

In their opposing brief, Respondent has avoided a direct response to these arguments and instead has characterized the Court of Appeals' decision as simply a correction of a distorted and misstated rendition of the "total mix" test. Res. at 16-18. As demonstrated below, however, the test was set forth by the District Court exactly as prescribed by this Court, and Respondent's opposition has served only to highlight the appellate court's misunderstanding of the test and the clear need for summary reversal of its decision.

A. The Court of Appeals' Decision is Plainly Erroneous

Respondent has characterized the Court of Appeals' decision as merely a rejection of a "unique" charge that "grossly distorted and misstated the 'total mix' test." Res. at 16. That is absolutely incorrect. This Court's statement of the "total mix" test is as follows:

> there must be a *substantial likelihood* that the *disclosure of the omitted fact* would have been viewed by the *reasonable investor* as having *significantly altered the "total mix" of the information made available.*

TSC Industries, Inc. v. *Northway, Inc.*, 426 U.S. 438, 449 (1976) (emphasis added) (footnote omitted). The District Court charged the jury precisely in accordance with that precedent:

> In the context of this case a fact is material when there is a *substantial likelihood* that, if a *reasonable investor* had learned of

[1] References to the Petition or to an appendix thereto are cited as "Pet. at ____" or "Pet. App. at ____," respectively. References to the Respondent's Opposition or to the Appendix thereto are cited as "Res. at ___" or "Res. App. at ___," respectively.

> the falsity of the misstatement of fact or the *existence of the omitted fact*, that investor would have regarded *the total mix of information available to have been significantly altered.*

Pet. App. at 5a n.2 (emphasis added). In fact, the Court of Appeals rejected a verbatim rendition of this Court's "total mix" test because it simply misunderstood the test.

(i) The Court of Appeals Completely Misunderstood this Court's "Total Mix" Test as Outcome-Determinative

The primary basis of the Court of Appeals' decision is that this verbatim rendition of this Court's "total mix" test is inappropriate, without further explanation, because it is "outcome-determinative":

> we think that the jury would take the "total mix" formulation to mean that a material fact is one that would cause a reasonable investor to change her decision on whether to consummate a transaction.

Pet. App. at 7a.

The Court of Appeals' understanding of the "total mix" test is simply incorrect. There is absolutely no equivalence between "alter[ing] the 'total mix' of information made available" and changing the ultimate decision on whether to consummate the transaction. In any event, altering the "total mix" suggests a *change in decision* no more than *TSC v. Northway*'s "consider important in deciding how to vote" test, its "significant propensity to affect the voting process" test, or its "important enough to assume actual significance in the deliberations of the reasonable shareholder" test, the use of which the Court of Appeals instructed on remand. Pet. App. at 10a. It is not surprising that Respondent has been unable to point in its opposition to a single instance in which any other court has rejected the "total mix" language because it "may" be construed as outcome-determinative, held that an instruction based on it is erroneous unless embellished, or suggested that it is different from any of the alternative formulations of the materiality definition in *TSC v. Northway.*

(ii) The Court of Appeals Completely Misunderstood the District Court's "Alter Views as to the Desirability" Explanation of the "Total Mix" Test as Outcome-Determinative

In an effort to explain the "total mix" concept to the jury, the District Court charged further that "significantly altering the total mix of information available" means that the omitted information "would have caused [the reasonable investor] to *alter its views as to the desirability of proceeding* with the purchase." Pet. App. at 5a n.2 (emphasis added). In reversing, the Court of Appeals ruled that, like this Court's "total mix" test, this explanation also "may have" led the jury to believe it was required to find that the investor actually *changed its decision* because of the alleged misstatement—*i.e.*, that the "alter views as to the desirability" language is also outcome-determinative.[2] This ruling is incorrect on its face and demonstrates an even more profound misunderstanding by the Court of Appeals of the District Court's charge and of the concept of outcome-determinativeness.

Clearly, the word "alter" in this portion of the District Court's charge modified only "views as to the desirability," and "altering views as to the desirability" does not mean "altering the decision." The desirability of proceeding may be increased so as to confirm a decision to proceed, or it may be decreased, but not so much as to cause a change in plans. "[A]lter[ing one's] views as to the desirability of proceeding," is simply not the equivalent of "changing one's mind about whether to proceed." Indeed, under the *TSC v. Northway* test, a "material" fact would necessarily alter, at least to some degree, one's view as to the desirability of proceeding with the transaction, for a fact could not be "consider[ed] important in deciding how to vote," "have a significant propensity to affect the voting process," "assume[] actual significance in the deliberations of the reasonable shareholder," or be

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[2] Despite Respondent's suggestions to the contrary, the Court's decision was not a rejection only of the District Court's "alter views as to the desirability" language. Indeed, the Court stated unequivocally that the *TSC v. Northway* formulation of the "total mix" test was outcome-determinative and that this language merely "compounded" the "misleading" charge on the "total mix" test. Pet. App. at 7a.

substantially likely to be "viewed by the reasonable investor as having significantly altered the 'total mix' of information available" and not also "cause[] [the reasonable investor] to alter its view as to the desirability of proceeding with the purchase."

B. The Court of Appeals' Decision Has Eviscerated This Court's "Total Mix" Test

We respectfully submit that the very fact that the United States Court of Appeals for the Second Circuit found the District Court's verbatim rendition of the "total mix" test to be, as Respondent suggests, a "grossly distorted and misstated view of the 'total mix' test" is precisely the reason that this Court should summarily reverse the decision below. Such an appellate ruling can only have the effect of eviscerating this Court's "total mix" test. District judges and litigants will not, and as a practical matter should not, utilize the "total mix" test in the wake of such a dramatic result. *See, e.g., Katz v. Pels*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,125 at 90,698 n.4 (S.D.N.Y. July 22, 1991).

C. This Court Should Summarily Reverse the Court of Appeals' Decision

The Court of Appeals' rejection of the "total mix" test is in direct conflict with this Court's established precedent. Because the charge was based directly on this Court's authority, the Court of Appeals' reversal was necessarily wrong. This Court should reverse to avoid the needless retrying of a seven-week trial in a mundane commercial dispute. Of greater significance, a swift reversal by this Court will restore its "total mix" test for all litigants. We respectfully urge this Court to exercise its powers of summary reversal.

CONCLUSION

For the foregoing reasons, the Petition should be granted and this Court should summarily reverse the Court of Appeals' decision.

Dated: November 22, 1991

Respectfully submitted,

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